

Annual Report 1986



C O N T E N T S

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C N C P P R O F I L E

As a national facilities-based telecommunications carrier, CNCP provides a wide range of services in the competitive segment of the market. We offer services directly to customers and lease channels to other service providers and high volume users.

Formed by a merger of Canadian National Telecommunications (CNT) and Canadian Pacific Telecommunications (CPT) in 1980, CNCP's history predates its formal start six years ago.

The first telegram was sent from Toronto to Hamilton via a predecessor company in 1846 and that marked the beginning of rapid written communications in Canada. In 1947, CNT and CPT pooled their private line operations – the service which established private telecommunications networks for businesses and government organizations.

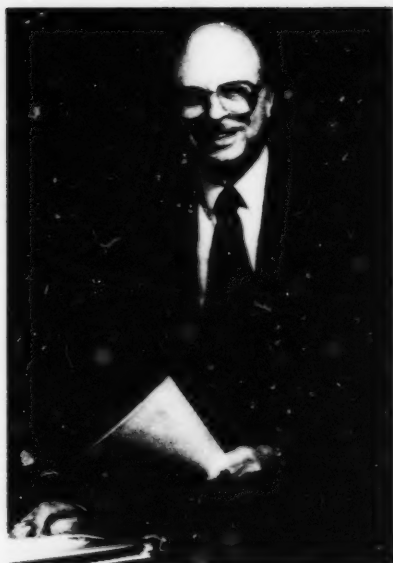
In 1956, CNT and CPT jointly introduced *Telex* service and went on to record many significant achievements. These include the building of a transcontinental microwave network in the late 1950s and early 1960s to provide greater capacity with higher quality and easier maintenance.

In 1967, *Broadband Exchange Service* was introduced by CNT and CPT jointly, and this was the first Canadian network specifically designed to meet the exacting requirements of high speed computer data. The network also provides high quality switched voice service.

CNCP's objective is to determine the communications needs of Canadians and Canadian businesses, to design programs to address these needs in a cost-effective manner, and to continually employ affordable technological advances in so doing.

Telecommunications is a fast growing industry in Canada. A young firm with a long history, CNCP plans to develop and utilize resources to assist customers in assessing their telecommunications needs and to work with them to develop products and services which are in step with tomorrow's emerging technologies.

P R E S I D E N T ' S M E S S A G E



The year 1986 was an important one for CNCP – a year in which our Company established itself as an industry leader in the development and application of fibre optic technology and digital capability for inter-city telecommunications. We were successful in laying hundreds of kilometers of fibre optic cable, developing products designed to effectively use fibre and in signing up several significant national accounts. Through strong efforts, CNCP has moved ahead quickly with plans to install digital networks in central and western Canada. Our plans are to continue to expand that program and to compete more effectively.

Mach III Developed During 1986

It was during 1986 that CNCP developed *Mach III* service, a product employing digital and fibre optic technology, and especially designed to be flexible in meeting customer needs. Using high bandwidth facilities, *Mach III* permits the transmission of voice, data and image on one customer network, eliminating a requirement for multiple networks.

With *Mach III*, one network can be designed to serve multiple purposes and changes can be effected when customers' needs change. CNCP gained a strong foothold in this market through the development of *Mach III* and made a significant move forward in the application of digital technology.

Telex

Over the years, CNCP has built a strong and reliable *Telex* service. We have been able to offer our customers access to a worldwide communications network connecting about two million subscribers in over 160 countries. Last year, in a research study on our *Telex* service, Canadian businesses were asked to rate the effectiveness of this product as a modern communications tool. We are now using the findings to develop business and promotional plans for this product and will continue to be responsive to specific customer communications needs.

CNCP's *Telex* network has played a major role in Canadian telecommunications since its inception in Canada in 1956. It continues to be recognized internationally as a world standard for the efficient and effective transmission of information. When the recipient must have a hard copy of a message, or a message has to be transmitted across many world time zones, CNCP's *Telex* network remains unsurpassed.

CNCP also is a leader through its *Teletex* service. *Teletex*, an international electronic text communication service, is considered by some experts as the most significant development in telecommunications since the standardization of the international telephone service. *Teletex* offers the customer the

services of an electronic typewriter and a word processor. A major feature of *Teletex* this year was its connection to the Canadian *Telex* network.

Teletex now is a national service in about thirty industrialized countries and another twenty are expected to be added during 1987.

CNCP Develops Lasercourier Service

CNCP is confined by government regulations to compete in a relatively narrow section of the marketplace. We cannot provide services in over ninety per cent of Canada's telecommunications market because the regulations have created this large monopoly for the telephone companies. To grow and prosper, we must be continually innovative. At CNCP, we have taken a bold new step and have forged a joint business venture with a major Canadian-based courier company - Purolator Courier Ltd. - to help us address a specific communication need existing from St. John's to Victoria. There are few services in Canada where printed messages can be delivered from door to door, quickly and economically. CNCP was challenged by the business community to better the services already in place. CNCP has met the challenge with the development of *Lasercourier*. This product is entering the marketplace in 1987 with the ability to deliver hard copy information

between two points in Canada twice as fast as its nearest competitor and at cheaper rates.

An important feature of *Lasercourier* is easy access. A customer can use it without purchasing any additional equipment. Subscribers to either of CNCP's *Telex* or *Dialcom* electronic mail service can send *Lasercourier* messages from their respective terminals. Others can simply phone or visit their nearest CNCP Public Message Centre and dictate a message to one of our representatives. This new service highlights one of our strengths at CNCP: the ability to bring products to market to fill specific communications needs at reasonable rates.

Financial Performance

From a financial performance standpoint, CNCP's 1986 revenues, at \$344 million, were marginally less than 1985; the first time our Company has recorded a revenue decrease since its formation in 1980. It is difficult to achieve revenue growth at a time when CNCP is committed to providing faster, easier and lower-priced methods of communicating for our customers; when it is denied access to ninety per cent of the Canadian telecommunications services market by outdated government procedures; when monopoly markets are receiving prolonged protection; and, when waves of new competition are fragmenting the small competitive market.

Expenses before income taxes for 1986 totalled \$312 million: 0.3% more than 1985, with after tax profits

of \$14 million. During 1986 CNCP invested \$61.1 million in new capital expenditures. All of us at CNCP are committed to our role as an effective national carrier in Canada's emerging information age and to the spending program which this mandate entails.

Competition in Long Distance Public Voice Services

In the regulatory and policy arena, CNCP continues to object strongly to being limited to operate in a very restrictive marketplace.

It was a setback to CNCP in 1986 when the Canadian Radio-television and Telecommunications Commission (CRTC) refused to review its earlier decision prohibiting CNCP from providing long distance telephone service in competition with the telephone companies. We have not wavered from our original assessment that CNCP has the professional and technical expertise and business know-how to provide competitive voice service to Canadians with features and prices that users want. CNCP holds the view that competition also will create a climate whereby those already providing service will be forced to keep prices down and provide more and better services to the consumer. CNCP is continuing discussions with government concerning the formulation of a pro-competitive tele-

communications policy. By expressing our views before the governmental authorities, CNCP makes them aware of the needs of users and the benefits of competition. We will do all in our power to have existing restrictions on market entry removed.

One Regulatory Body

It is our belief that telecommunications in Canada should be governed by one regulatory body to ensure an equivalent level of service from St. John's to Victoria. At present, CRTC regulation is largely confined to Ontario, Quebec and British Columbia; the other seven provinces essentially fall under provincial regulation for telecommunications. This splintered jurisdiction over telecommunications results in uneven and often contradictory decisions. One consequence is that outside CRTC-regulated territories, telecommunications users are denied interconnected data and private line voice services which possess competitive advantages and lower rates for the customer. CNCP's planning calls for determined efforts to

provide all services to users across Canada. In late 1985, our position received a significant boost when the Federal Court of Appeal stated that effectively, Alberta Government Telephones (AGT) is subject to regulation by the CRTC. AGT now has appealed that decision to the Supreme Court of Canada. A decision is expected in late 1988.

We Make Our Views Known

It is a fact that, as a regulated and policy controlled carrier, CNCP must be proactive in making its policy views known before government including the Commons and Senate legislative committees. Throughout 1986, we have made it a point to participate in such hearings and to bring forth our viewpoints on telecommunications issues where public representation was permitted. In many cases, CNCP supported the proposed legislative changes. In one area, a proposed tax on carriers regulated by the CRTC, CNCP is strongly opposing the additional expense. CNCP already is regulated by competitive market forces and we believe that CRTC supervision of CNCP operations is an additional form of unnecessary regulation for CNCP. We therefore are seeking the reduction or elimination of this tax.

Looking Ahead

We realize that CNCP must continue to compete effectively in an artificially restricted marketplace. During 1987, we will attempt to widen the scope of that marketplace. We will pursue entry to the long distance voice market. We will introduce new and enhanced products to better address the customers' telecommunications needs. CNCP will pursue the ability to offer our full range of business services in all provinces. We have the people, the products and business know-how to make CNCP a more integral and effective force in the Canadian telecommunications industry.



J.G. Sutherland
President and Chief Executive Officer

A LOOK BACK

Many opportunities arose during 1986 in which CNCP played prominent roles in addressing customer needs through existing or special products and services. Developing telecommunication solutions, providing fibre optic transmissions for Expo '86 and providing special services to the airline industry, for example, helped our Company use its expertise for the benefit of Canadians and Canadian businesses.

CNCP Provides Telecommunications Access for Hudson's Bay Company

Canada's oldest company, Hudson's Bay Company, is one of the first CNCP customers to use modern fibre optic transmission through CNCP's new *Mach III* service. In a desire to improve telecommunications capabilities, CNCP and Hudson's Bay Company recognized the need for a large capacity telecommunications access into the company's computer centre in Toronto. The requirement demanded a mixture of CNCP services like *Mach III*, high speed computer-to-computer circuitry and low speed circuits to serve their administration and point-of-sale networks.

Through the innovative use of technologies in a highly responsive time frame, CNCP met Hudson's Bay Company requirements. As a result of our efforts, CNCP has received additional orders from this firm for such services as *Mach III* from Toronto to

Montreal, high speed computer-to-computer circuitry to Vancouver and Calgary, and a large number of administration and point-of-sale circuits with drops across the country.

CNCP Contributes to Air Safety

In March of 1986, CNCP completed a project which contributes significantly to the improvement of air safety in Canada. Known as 'Notices to Airmen', this new foreign database co-exists with the domestic database and provides air crews with up-to-date information on air, flight and ground conditions.

Because of the public importance and ability of this particular database, it is imperative that the performance level be maintained at greater than 99.85%. The 'Notices to Airmen' database of CNCP is operating at 99.99% availability.

CNCP Helps to Put Air Canada Back in Business in Record Time

When a disastrous fire struck the Alexis Nihon Plaza in Montreal in October, 1986, 330 Air Canada travel agencies and airline reservation offices connected to the Air Canada Reservec system went out of service in Montreal and the Eastern Townships. Before the fire was extinguished, members of the CNCP team were already in action to help Air Canada get back into business.

Replacement equipment for circuits was acquired, cable facilities to the new Air Canada location were identified, equipment was placed on racks and wired, internal cross-connections were completed, and within a record time of 32 hours, Air Canada's Reservec system was back in service.

Another example of CNCP's response to customer needs and the commitment to keep the customer in service was thus recorded.

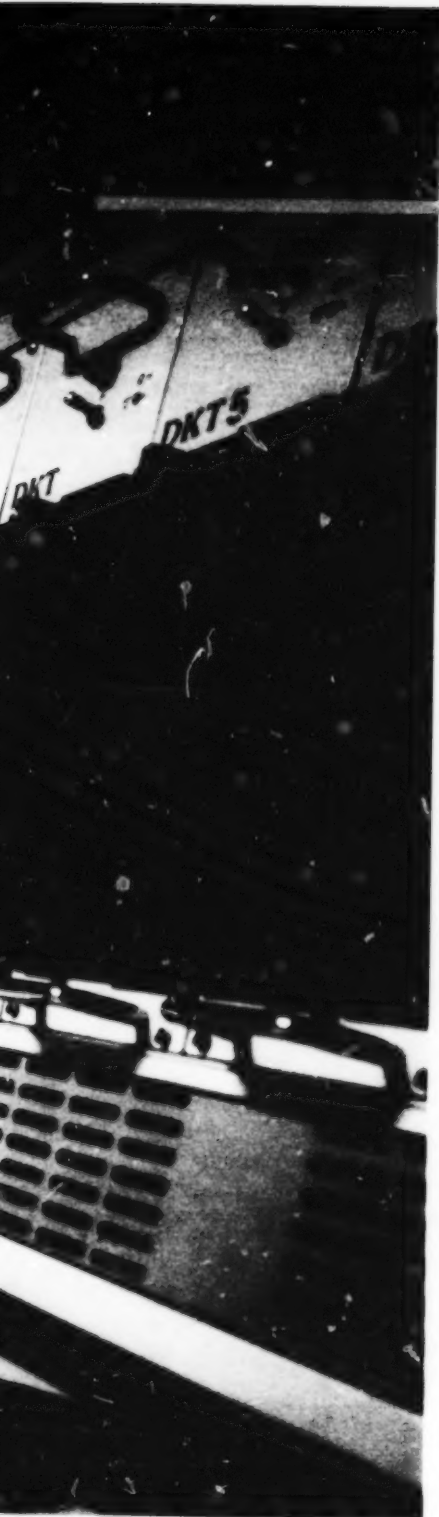
CNCP at Expo '86

CNCP demonstrated its telecommunication skills in two displays at Expo '86 in Vancouver. A CNCP display in the Predictions area of the Canada Pavilion demonstrated the important role of television video technology in communications. Visitors to the exhibit were impressed while viewing the new methods of communicating and saw how effectively CNCP was using the technology, television cameras and monitors to link two or more meetings occurring at separate locations. Most of this interaction between groups in two separate meetings has been through teleconferencing using the telephone system.

Another innovative application and display of technology by CNCP was associated with the construction of a number of periscopes linking the Canada Pavilion and the main set of Expo '86. Television cameras and receivers were interconnected by special switches and fibre optic cables to enable persons at any one periscope to view objects within television sight of any other selected periscope. The fibre optic cables were installed by CNCP personnel. CNCP microwave and equipment technicians participated in the installation and testing of the components for the entire system. This highlighted CNCP's leadership role in the development and application of fibre optic technology.



The development of Mach III and success stories in Infodat and Infoswitch were highlights of 1986 for Data Services. Flexibility and innovation enabled CNCP to find new and better ways to serve our customers.



DATA SERVICES

Digital technology has opened the doors to the development of a new product by CNCP which combines various types of transmission on one network. The Data product line was enhanced in 1986 with the development and introduction of *Mach III*. This new service gives customers the flexibility to use their network for voice, data or imagery transmission. We have been able to offer *Mach III* as a digital service to Canadian users. We have great confidence in the benefits *Mach III* will give to Data customers in cost savings and efficiency of use.

We are looking forward to developing further uses of the digital technology to continually identify better ways to meet needs, especially the transmission requirements of our customers.

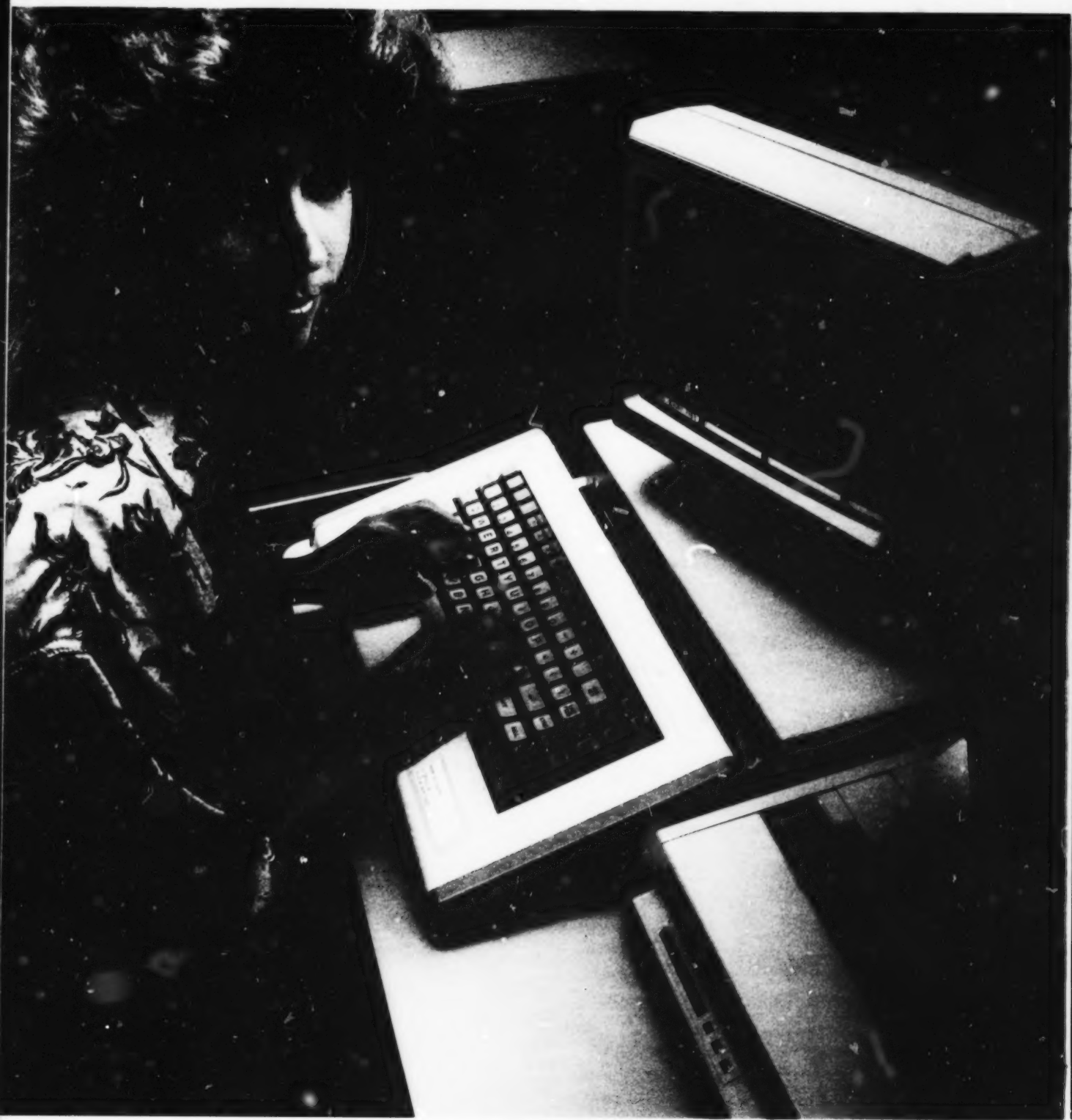
During 1986, CNCP's *Infoswitch* service continued its expansion and modernization program. The *Infoswitch* service is the only one in Canada which observes both international and IBM transmission standards. For a customer like a bank, for example, the same standards can be used to design its automatic teller machines and the lines to the main computers. Information to and from the machines can be transmitted on lines shared with other customers without encountering a different set of standards. This results in cost savings to the bank.

Unique features and competitive costs of CNCP's *Infoswitch* service have enabled CNCP to become the packet switching supplier for the Government Telecommunications Agency (GTA). GTA is the manager of common telecommunications services for the Federal Government. CNCP is awaiting CRTC approval of the tariff.

Another growing Data Service is our private line digital service called *Infodat*. We are opening up new serving areas in smaller Canadian urban areas and connecting them to networks in Canada and the United States. *Infodat* has the potential for continued growth in applications where continual data transmission capacity is required between two or more computers.

The development of Data Services has been considerably enhanced through the creation of dedicated teams within CNCP. This team approach helped in our development of *Mach III* and led to improvements in *Infoswitch* and *Infodat*. We look forward to continued success in 1987.





access allows one messaging customer to communicate directly with another, even though they may be using different pieces of equipment.

MESSAGE SERVICES

Significant events throughout the past 12 months in the Message Services business have resulted in severe pressure from outside on CNCP's Messaging base but have also produced very real developments which have positioned the Company for future stability and growth. In many respects the entire product line has been renewed in terms of customer literature, customer support and new products.

The entire product line was brought under the umbrella of a service concept called *access*: a significant technological advantage possessed by CNCP. With *access*, customers using one Message Service of CNCP can communicate directly with another customer using another Message Service. For example, a *Telex* customer can communicate to a *Teletex* customer, and a customer using *Dialcom* electronic office services can communicate directly to a *Telex* or *Teletex* customer and vice versa. Therefore, CNCP provides, to the user base, the ability to access any other client service from the one to which they subscribe.

An important Message Service product development occurred in 1986 with the development of *Lascourier* service. *Lascourier* enables any one of CNCP's Messaging customers to have access to 28 laser printers which are located in 18 Purolator Courier offices. Electronically-inputted messages can be delivered within 90 minutes of receipt at the destination printer. This service fills the gap in the marketplace which requires urgent delivery of messages with high quality print, with universal access, (access is either via

Telex, *Teletex*, *Dialcom* or through the PMS offices by telephone or in person) and for universal delivery to an increasing number of addresses across Canada.

The *Telex* business has been important to CNCP's success. In 1986, we introduced *PC Telex* which enables PCs to access the world's most popular messaging network. In addition, a screen-based *Telex* terminal was introduced at the beginning of the year and was responsible for a significant increase in CNCP's terminal sales to the *Telex* user base. This terminal, the *Telemode 4000EJ*, became Canada's most popular *Telex* terminal in 1986.

While it is clear that there are significant forces within the marketplace which create a real challenge for the Company in the Message Services business, continued refinement of our services, focusing of our objectives, and improvement of our customer support capabilities will re-position CNCP's Message Services business for the dominance that it has enjoyed over the past many years.





Digital capabilities were introduced across all Voice product lines in 1986. The introduction of this modern technology is part of an overall strategy and will permit CNCP to offer more innovative products now and in the future.

VOICE SERVICES

Voice Services experienced a year of growth and innovation in 1986 as we introduced digital capabilities across all product lines.

Perhaps the most significant activity in 1986 was the commitment by CNCP to upgrade and expand the *Broadband Exchange Network* by using digital technology. *Broadband*, first introduced in 1967, was Canada's first private access alternate voice/data switched network. The expansion and enhancement of the network will give CNCP the ability to offer integrated digital voice and data services, priced and packaged to meet the needs of medium-sized businesses.

Broadband was not the only area of activity. The application of digital technology to the leased products resulted in improved product quality and expanded opportunities for Voice. A digital version of *Econovoice* service, which allows a customer to derive two voice channels from a single channel at savings of up to 30%, was introduced in 1986.

The implementation of digital technology in CNCP's Voice Services is part of an overall strategy to ensure that CNCP is able to offer innovative products to as wide a range of customers as possible – both today and into the 1990s. With the implementation of digital switching and transmission across the network, CNCP's Voice Services is entering the world of Integrated Services Digital Networks, which will form the basis of many new CNCP products and services over future decades.

Innovation and product enrichment was the theme for Voice Services in 1986 and we continue to build on that theme towards an even brighter performance in 1987.



DIRECTORS AND OFFICERS

Board of Directors

- [†]J.G. Sutherland
President & Chief
Executive Officer
CNCP Telecommunications
- ^{**†}D.C. Campbell
President
Canadian National
Communications
- ^{**†}J.T. Clough
Vice-President
Finance & Accounting
Canadian Pacific Limited
- ^{**†}A.E. Deegan
Group Vice-President
Canadian National
- R.K. Garney
Group Vice-President
Canadian Pacific Limited
- Dr J.M. LeClair
Chairman & Chief
Executive Officer
Canadian National
- ^{**†}C.R.O. Munro, Q.C.
Vice-President
Law and General Counsel
Canadian Pacific Limited

Officers

- [†]J.G. Sutherland
President & Chief
Executive Officer
- [†]E.J. Coady
Executive Vice-President
- A.M. Bucknall
Secretary

Vice-Presidents

- G.F. Carleton
Marketing
- S.D. Daly
Corporate Planning
- P. Lamarche
Operations
- R.C. Pachal
Engineering
- J.S. Schmidt
Regulatory & Governmental
Matters
- R.C. Short
Sales

*Member Audit Committee, [†]Member Pension Investment Committee, [°]Member Compensation Committee

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* Public Message Centres Are
Also Located in These Cities

CNCP Telecommunications

Financial Statements 1986

MANAGEMENT REPORT

Management is responsible for the integrity and objectivity of its financial statements, including the selection of appropriate accounting principles and making judgments and estimates in accordance with generally accepted accounting principles.

CNCP maintains a system of internal control which provides management with reasonable assurance that assets are safeguarded and that reliable financial records are maintained. The system includes a comprehensive program of audits carried out by CNCP's internal auditors. The Audit Committee, comprised of non-management directors of the Board, meets periodically with management, the internal auditors and the independent auditors to review the overall adequacy and effectiveness of the system of internal control. The directors have established a code of business conduct which sets forth the standards required of employees related to conflicts of interest and unauthorized disclosure of confidential information.

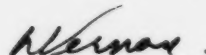
CNCP has appointed independent auditors to report on the Partnership's financial statements. Separate audited

financial statements are prepared covering the partnership operations for presentation to its partners. The accounts for the partnership for the year ended December 31, 1986 were examined by Touche Ross & Co., Chartered Accountants, and by Price Waterhouse, Chartered Accountants. Their report dated January 23, 1987 was unqualified.

The accompanying unaudited financial statements were prepared by management within the framework of the accounting policies summarized in Note 2 to these financial statements. These policies have been applied consistently. The unaudited financial statements reflect the activities of CNCP Telecommunications as a whole, combining the partnership accounts with the accounts recorded in the books of the partners relating to the partnership activities. Management is responsible for all information in the Annual Report. All financial and operating data in the Report are consistent, where appropriate, with that contained in the unaudited financial statements.



J.G. Sutherland
President and Chief
Executive Officer



L. Vernon
Controller

Toronto, Ontario
February 20, 1987

CNCP TELECOMMUNICATIONS FINANCIAL HIGHLIGHTS (Unaudited)

	1986	1985
Financial statistics (\$000)		
Revenue	343,757	349,124
Expenses before income taxes	312,223	313,006
Net income	13,975	16,584
Capital expenditures (including A.F.C.)	61,100	71,797
Net fixed assets	380,190	372,273
Financial ratios		
Return on average total capital	8.8%	9.8%

Financial information and commentary presented throughout this report are based on unaudited financial statements. They include the assets, liabilities, revenues and expenses of CNCP Telecommunications (a partnership) and assets and other expenses of the respective partners related to the CNCP Telecommunications operations. (See Note 1 to the Financial Statements for more information.)

FINANCIAL PERFORMANCE

Net Income

The unaudited net income for 1986 was \$14.0 million, a decrease of \$2.6 million from 1985. The rate of return on average total capital declined to 8.8% in 1986 from 9.8%

in 1985. The company is seeking to improve revenues and further reduce costs in 1987.

Revenue

Revenue for 1986 was \$344 million, a decline of 1.5% from 1985. The Message revenues declined by 6.9% primarily in the rental of equipment as a result of customers purchasing their own terminals. Private line and public packet

switching data contributed to the 11% increase in Data revenue. The Voice revenues totaled the same as the previous year.

Expenses

Expenses before income taxes for 1986 totalled \$312 million, a decrease of \$0.8 million from 1985. The two expense categories - local distribution and other facilities leased from local telephone companies and labour - were held at the same level as the previous year. Depreciation

expense was \$3.1 million higher than 1985 primarily as a result of an increase in rates of depreciation for certain asset categories - particularly subscriber terminals. This was offset by lower costs in other areas including a significant reduction in discretionary expenditures.

Capital Expenditures

CNCP invested \$61.1 million in plant and equipment in 1986 (including the allowance for funds used during construction). The installation of the fibre optic transmission system continued in Central and Western Canada. Customers in the Montreal-Toronto-Ottawa triangle were served by this new high quality facility in 1986 and cable was laid from Toronto-Kitchener for service early in 1987. In the West, the fibre link was completed westward from Kamloops toward Vancouver for service early in 1987 with

the section east from Kamloops to Edmonton to be constructed in 1987/88. In addition to opening up high capacity data facilities and attracting high volume customers, this network of fibre cable will help reduce dependence on facilities leased from local telephone companies. Other investments included installation of additional multiplex equipment, switching computers and expansion and upgrading of test facilities.

FIVE YEAR SUMMARY (Unaudited)

	1986	1985	1984 Restated	1983	1982
Selected financial position items (\$000)					
Net fixed assets	380,190	372,273	351,567	350,093	350,105
Capital expenditures (including A.F.C.)	61,100	71,797	52,663	44,743	67,977
Total assets	431,821	433,713	414,085	401,925	406,478
Debt due to partners	139,387	145,044	134,619	154,508	169,471
Equity	206,581	199,564	194,290	175,014	168,761
Selected income and expense items (\$000)					
Revenue	343,757	349,124	338,093	315,014	302,203
Expenses before income taxes	312,223	313,006	306,334	289,646	279,915
Depreciation	52,226	49,124	46,809	44,753	41,031
Debt costs	16,562	16,469	15,683	16,349	16,178
Net income	13,975	16,584	15,524	12,506	10,810
Financial statistics					
Debt ratio	40.3%	42.1%	40.9%	46.9%	50.1%
Embedded cost of debt	11.7%	11.8%	10.8%	10.1%	9.8%
Return on average total capital	8.8%	9.8%	9.5%	8.6%	8.3%
Miscellaneous statistics					
Employees	3,633	3,906	3,937	3,969	4,154
Salaries & wages (\$000)	111,598	111,675	102,535	104,614	100,322
Revenue per employee (\$)	94,621	89,381	85,876	79,369	72,750

BALANCE SHEET AS AT DECEMBER 31 (Unaudited)

(in thousands)	1986	1985
Assets		
Current assets:		
Accounts receivable	\$ 31,322	\$ 35,318
Prepaid expenses	3,322	3,229
Materials and supplies	3,383	5,418
	38,027	43,965
Fixed assets (Note 3)	380,190	372,273
Employee loans receivable (Note 4)	2,671	2,630
Deferred unrealized exchange loss (Note 2 (h))	10,933	14,845
Total assets	\$431,821	\$433,713
Liabilities and Partners' Equity		
Accounts payable and accrued liabilities	\$ 54,186	\$ 56,928
Debt due to partners (Notes 2(e) and 5)	139,387	145,044
Deferred income taxes (Note 2(f))	31,667	32,177
Partners' equity	197,668	190,681
Foreign currency translation adjustment	8,913	8,883
Total liabilities and partners' equity	\$431,821	\$433,713

STATEMENT OF INCOME FOR THE YEARS ENDED DECEMBER 31 (Unaudited)

(in thousands)	1986	1985
Revenue	\$343,757	\$349,124
Expenses:		
Operating, administration and general	243,435	247,413
Depreciation -		
CNCP owned assets	30,973	23,855
Partners' contributed assets	21,253	25,269
Debt	16,562	16,469
	312,223	313,006
Income before income taxes	31,534	36,118
Provision for income taxes (Note 2(f))	17,559	19,534
Net income	\$ 13,975	\$ 16,584

(See accompanying notes to the Financial Statements)

STATEMENT OF PARTNERS' EQUITY FOR THE YEARS ENDED DECEMBER 31 (Unaudited)

(in thousands)	1986	1985
Partners' equity, beginning of year, as previously reported	\$190,681	\$183,163
Amortization of unrealized exchange loss, net of income taxes of \$260,000 (Note 2(i))	—	774
Partners' equity, as restated	190,681	182,389
Net income	13,975	16,584
Partners' distribution (Note 2(g))	(6,988)	(8,292)
Partners' equity, end of year	\$197,668	\$190,681

STATEMENT OF CHANGES IN FINANCIAL POSITION FOR THE YEARS ENDED DECEMBER 31 (Unaudited)

(in thousands)	1986	1985
Operating Activities		
Net income	\$13,975	\$16,584
Items not affecting cash		
Depreciation and amortization of fixed assets	52,226	49,124
Allowance for funds used during construction	(724)	(1,269)
Gain on disposal of fixed assets	(680)	—
Deferred income taxes	(510)	487
Amortization of unrealized exchange loss	2,514	2,749
Realized exchange loss	(2,785)	—
	64,016	67,675
Net change in non cash working capital balances	3,196	9,108
	67,212	76,783
Partners' distribution	(6,988)	(8,292)
Total cash generated from operating activities	\$60,224	\$68,491
Investment Activities		
Capital Expenditures		
CNCP Fixed asset additions, excluding allowance for funds used during construction	\$60,327	\$70,525
Partners' contributed assets	49	3
Dismantling, Salvage and adjustments, net	(1,637)	(1,967)
Increase (decrease) in employee loans	41	(63)
Total cash used for investment activities	\$58,780	\$68,498
Financing Activities		
Decrease (increase) in debt due to partners	1,444	(7)
Total cash used (generated) from financing activities	1,444	(7)

(See accompanying notes to the financial statements)

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 1986 (Unaudited)

1. Combined financial reporting and basis of preparation of financial statements:

CNCP Telecommunications (CNCP) was formed on January 1, 1980 as a partnership combining certain of the telecommunications operations of Canadian National Railway Company (CNR) and of Canadian Pacific Limited (CPL). Under the terms of the partnership agreement, certain telecommunications assets owned by the partners are used by the Partnership, however, the ownership was retained by the Partners.

The unaudited CNCP Financial Statements presented in this report reflect the operations of CNCP as a whole. They

include the Partnership's assets, liabilities, revenues and expenses, together with certain telecommunications assets which are recorded in the books of the partners, associated debt assigned by the partners and other corporate costs including the partners' depreciation, debt charges and corporate overheads related to CNCP Telecommunications.

A summary of the significant accounting policies used in preparing these combined Financial Statements are described in Note 2.

A summary of the accounts is as follows:

(in thousands)	1986		1985	
	CNCP	Held by Partners	Total	Total
Current assets	\$ 40,323	\$ (2,296)	\$ 38,027	\$ 43,965
Fixed assets, net	264,846	115,344	380,190	372,273
Other assets	2,671	10,933	13,604	17,475
	<u>\$307,840</u>	<u>\$123,981</u>	<u>\$431,821</u>	<u>\$433,713</u>
Current liabilities	\$ 54,186	\$ —	\$ 54,186	\$ 56,328
Debt due to partners and deferred income taxes	—	171,054	171,054	177,221
	54,186	171,054	225,240	234,149
Partners' equity	253,654	(47,073)	206,581	199,564
	<u>\$307,840</u>	<u>\$123,981</u>	<u>\$431,821</u>	<u>\$433,713</u>
Revenue	\$343,757	\$ —	\$343,757	\$349,124
Expenses	270,329	59,453	329,782	332,540
Net income	<u>\$ 73,428</u>	<u>\$ (59,453)</u>	<u>\$ 13,975</u>	<u>\$ 16,584</u>

2. Summary of significant accounting policies:

The accompanying Financial Statements have been prepared on a combined basis as described in Note 1. CNCP is regulated by the Canadian Radio-television and Telecommunications Commission (CRTC).

(a) Revenue recognition -

Revenue is recognized when billed, which approximates the time the service is provided.

(b) Materials and supplies -

Materials and supplies are carried at cost less a provision for obsolescence.

(c) Fixed assets -

Fixed assets are carried at cost. Depreciation is calculated using the straight-line method at rates approved by the CRTC which are based on the estimated useful lives of the assets. Leasehold improvements are amortized using the straight-line method over the terms of the leases, generally ten years.

(d) Allowance for funds used during construction -

Regulatory authorities require the Partnership to provide for a return on capital invested in certain new plant while under construction. An allowance, based upon the prior year's return on investment, for funds used during construction is included as an item of income during the construction period and also as an addition to the cost of the plant constructed. Such income is not realized in cash currently but will be realized over the service life of the plant.

(e) Debt due to partners -

The debt represents a notional liability that has been assigned by the partners from their respective pools of long-term debt. There are no debt instruments issued by CNCP. The interest paid by the partners on the assigned debt has been assumed to arrive at the interest expense in the Statement of Income.

The assigned debt payable in foreign currencies is reflected in the Financial Statements at the Canadian dollar equivalent at the rate of exchange prevailing at the balance sheet dates. Resulting gains or losses are amortized over the remaining term of the debt.

The debt is reflected as a long-term liability which corresponds to the long-term nature of the assets to which it relates.

(f) Income taxes -

CNCP is a partnership and as such its income is reported as part of the respective partners' income for income tax purposes. The current and deferred income tax provision included in these Financial Statements has been computed in order to reflect a charge for income taxes as if CNCP were a separate corporate entity. The deferred portion of this charge relates to differences in timing of recognition of revenues and expenses for financial statement purposes and those recorded in the tax returns of the partners.

(g) Partners' distribution -

Income or loss from the operations of the Partnership is shared equally by the partners from which the partners' expenses are deducted. A notional distribution of 50% of net income after partners expenses and income taxes is reflected in the Statement of Partners' Equity.

(h) Foreign currency translation -

Debt denominated in a foreign currency has been translated at the exchange rate in effect at the balance sheet date. The resulting overall unrealized exchange loss on the translation of all foreign currency debt with fixed maturities is recorded as a deferred charge in the balance sheet. This charge is being amortized on a straight line basis over the remaining terms of the related debt.

Included in the notional debt assigned to CNCP is an amount related to foreign issued perpetual 4% consolidated debenture stock. The credit arising on the translation of this debt at December 31 is included as a separate amount in partners' equity.

3. Fixed assets:

Fixed assets and related accumulated depreciation and amortization are as follows:

(in thousands)	1986		1985	
	Cost	Accumulated Depreciation & Amortization	Net Book Value	Net Book Value
Transmission facilities	\$317,515	\$136,075	\$181,440	\$166,503
Switching facilities	109,940	65,980	43,960	47,475
Terminals and related equipment	189,741	117,808	71,933	81,293
Land and Structures	27,456	6,412	21,044	19,030
Other fixed assets	100,195	39,155	61,040	57,009
	744,847	365,430	379,417	371,310
Leasehold improvements	1,868	1,095	773	963
	<u>\$746,715</u>	<u>\$366,525</u>	<u>\$380,190</u>	<u>\$372,273</u>

4. Employee loans receivable:

CNCP has extended mortgage loans, repayable over periods up to 20 years, to certain employees to assist in relocating. In addition, loans have been extended to employees for the purchase of computer equipment. These loans are repayable over periods up to two years.

(in thousands)	1986	1985
Employee housing loans	\$2,448	\$2,630
Employee computer loans	223	—
	<u>\$2,671</u>	<u>\$2,630</u>

5. Debt due to partners:

The debt has been assigned by the Partners from their respective pools of long-term debt as follows:

(in thousands)	1986	1985
Debt assigned -		
Canadian National Railway Company	\$ 84,286	\$ 86,960
Canadian Pacific Limited	55,101	58,084
	<u>\$139,387</u>	<u>\$145,044</u>

6. Pensions and benefits:

CNCP has contributory and non-contributory pension plans covering substantially all of its employees. Pension costs for current and past service are charged to income as funded. Based on the last actuarial valuation, the total unfunded liability at January 1, 1984 was \$5,000,000. This

liability was reduced as a result of payments made and expensed in excess of that required to be funded. Based on the performance of the pension plans, it is management's opinion that there is no longer an unfunded liability in the plans. A full actuarial valuation will be prepared in 1987.

7. Related party transactions:

Interchanges of services of a routine and special nature are undertaken between CNCP and the Partners and certain of their subsidiaries. The nature and extent of these services are as follows:

(in thousands)	1986	1985
Services rendered by CNCP -		
Telecommunications	\$39,998	\$34,778
Open wire maintenance	4,084	4,671
	<u>\$44,082</u>	<u>\$39,449</u>
Services rendered to CNCP -		
Administrative	\$ 8,283	\$ 8,966
Open wire rental and boarding cars	437	484
	<u>\$ 8,720</u>	<u>\$ 9,450</u>

CNCP also provides services to and receives services from other companies affiliated with the Partners as part of its normal business transactions. These transactions are at terms and rates no more or less favourable than with unrelated parties.

8. Commitments:

The minimum payments in future for leased assets are as follows:

(in thousands)	
1987	\$15,758
1988	12,323
1989	9,383
1990	5,543
1991	2,700
1992 and thereafter	13,658

Commitments for capital expenditures amounted to \$19,241,322 at December 31, 1986 (1985 - \$7,449,000).